GOVERNOR'S BLUE RIBBON COMMISSION ON PUBLIC EMPLOYEES RETIREMENT SYSTEMS
MINUTES
JUNE 19, 2007

The Governor's Blue Ribbon Commission on Public Employees Retirement Systems was called to order by Chairman John Farris, Secretary, Finance and Administration Cabinet, on Tuesday, June 19, 2007 in Room 149 of the Capitol Annex.

Secretary Farris called the roll and the following members were present: Jack Adams, Commissioner, Kentucky State Police; Bob Arnold, Executive Director, Kentucky Association of Counties; Mark Birdwhistell, Secretary, Cabinet for Health and Family Services; Robert Brown, Executive Director, Kentucky Public Employees Deferred Compensation Authority; Brad Cowgill, State Budget Director; Brian Crall, Secretary, Personnel Cabinet; David G. Dowell, gubernatorial appointee; John Hall, gubernatorial appointee; William P. Hanes, Executive Director, Kentucky Retirement Systems; Gary Harbin, Executive Secretary, Kentucky Teachers' Retirement Systems; Frank Hatfield, designee for Kentucky Retired Teachers Association; Lee Jackson, President, Kentucky Association of State Employees; Andrew Jacobs, gubernatorial appointee; David Jones, gubernatorial appointee; Sylvia Lovely, Executive Director, Kentucky League of Cities; Todd Lowe, gubernatorial appointee; Brent McKim, designee for Kentucky Education Association; Representative Harry Moberly, Chairman, House Appropriations and Revenue Committee; Senator Charlie Borders, Chairman, Senate Appropriations and Revenue Committee; Ronnie O'Nan, Executive Director, Kentucky Transportation Employees Association; James E. Parsons, gubernatorial appointee; Shawn Ridley, gubernatorial appointee; and Deborah Holland Tudor, gubernatorial appointee. Chairman Farris declared a quorum was present and that the press had been notified of the meeting

Secretary Farris stated that in light of earlier media reports, he felt it was necessary to reiterate that it has never been the intention of the Governor or the Commission not to honor the inviolable contract with current employees and retirees of the Commonwealth. He stated that he felt there has been a misunderstanding about the purpose of the Commission but assured everyone that it is important to understand the legal ramifications of honoring the contract.

Senator Borders stated that from a legislative perspective that he felt there had been some miscommunication about the intent of the legislature to make changes to the retirement systems. He stated that it the legislature's intent to only look at changes to the systems for future employees.

Lee Jackson, President, Kentucky Association of State Employees, read into the read record the an excerpt from City of Owensboro et al. v. Board of Trustees, City of Owensboro Employees Pension Fund, 301 Ky. 113, 190 S.W.2nd. 1005, December 7, 1945 which basically stated that repeal of the Civil Service Ordinance "...did not and could not affect the vested rights and inviolable contract of the employees who became such and qualified under the Civil Service Ordinance with it's operative life." Mr. Jackson also read from Zeitz v. Foley, 264 S.W.2nd 267, January 29, 1954 "...However contracts voluntarily made between competent persons are not to be set aside lightly. As the right of private contract is no small part of liberty of the citizen, the usual and most important function of courts is to enforce and maintain contracts rather than to enable parties to escape their obligations on the pretext of public policy or illegality. If the legality of the contract can be sustained in whole or in part under any reasonable interpretation of its provision, courts should not hesitate to decree enforcement."

Chairman Farris asked for a motion to approve the minutes of the May 14, 2007 meeting. A motion was made and seconded to approve the minutes of the May 14, 2007 meeting. Motion carried.

Chairman Farris indicated that all the working groups have met and each chair presented an update on the group's progress.

Brad Cowgill, State Budget Director and Chairman of Working Group 1-Funding Liabilities stated that Working Group 1 met on June 12, 2007. Mr. Cowgill stated that the scope of work for the group is predicting benefits for future service of current employees. Tom Cavanaugh, actuary for Kentucky Retirement Systems, and Ed McDonald, actuary for Kentucky Teachers' Retirement Systems, presented information to the working group with respect to the pension benefits of those groups. Mr. Cowgill stated that their first task is to understand what the obligations are. Mr. Cowgill stated that to arrive at the unfunded actuarial accrued liability, you subtract the actuarial value of the assets from the actuarial accrued liability. Mr. Cowgill pointed out that actuarial value is not the same as market value and it was explored considerably in the meeting. Mr. Cowgill said the group also learned that liabilities are based on numerous assumptions that are sensitive to anticipated return on investment. In addition, Mr. Cowgill stated that although very large, the unfunded actuarial liability is manageable by comparison with the health funds. Mr. Cowgill stated that the anticipated return on investment is what the actuary uses as a discount rate when they are discounting the stream of future benefits to participants in the system back to present value. Mr. Cowgill stated that presently the anticipated rate of investments for the Kentucky Retirement Systems is 7.75 percent and 7.50 percent for the Teachers' Retirement System. Mr. Cowgill reported that the experts indicated that 75 percent to 80 percent of the benefits that will be paid to the beneficiaries of the pension plans will come from investments.

Brian Crall, Secretary, Personnel Cabinet and Chairman of Working Group 2 reported that the working group held an organization meeting in May to identify any entities that want to have representation in the working group. Mr. Crall stated that the group is scheduled to meet on July 11, 2007 and both retirement systems will make a presentation to compare current pension benefits in each system to similar benefits for similar employees in surrounding states and further comparing benefits to the 50 states.

Mark Birdwhistell, Secretary, Cabinet for Health and Family Services and Chairman of Working Group 3 stated that he would like to echo Secretary Farris' comment that the focus of Working Group 3 has been and will continue to be the future of new hires and that benefits of current and retired employees is not within the scope of the working group's charge. Secretary Birdwhistell informed the Commission that the working group met on June 4, 2007 and Mike Burnside, Deputy Secretary, Finance and Administration Cabinet presented an update the benefits consultant RFP. In addition, Secretary Birdwhistell stated that Trudy Matthews updated the group on the Medicare Modernization Act which is germane to understanding current health benefits for the retiree population. He further added that Rick Schultz from the Kentucky Retirement System gave an update on the current benefit configurations are for the Kentucky Retirement System, the County Retirement System, and the State Police Retirement System. Secretary Birdwhistell stated the working group will meet again on July 10 and the group will be reviewing the benefits of current employees and the Kentucky employees benefit plans.

Secretary Farris asked Bill Hanes to introduce Joseph Wyatt, Jr., a partner in Morrison and Foerster, California, an expert in fiduciary law, who will serve as legal counsel to the Commission. Mr. Hanes stated that Mr. Wyatt is an author and lecturer on fiduciary or trust law and has provided fiduciary counsel to and represented numerous public pension fund clients. Mr. Hanes also stated that Mr. Wyatt is the author of *Trust Administration and Taxation*.

Secretary Farris asked Mr. Wyatt to speak to the Commission regarding his background and expertise. Mr. Wyatt stated that he had been practicing law since 1950 and for the last 35 years has served as a trust and fiduciary lawyer. Mr. Wyatt stated that in that 35 years he has represented an increasing number of public employee retirement systems as their fiduciary counsel sometimes in litigation, often in counseling trustees of public retirement systems. Mr. Wyatt stated he served on a public retirement board for 8 years and is familiar with the problems that public employees' retirement systems face. Mr. Wyatt indicated that he is a member of the American Law Institute which is a body of professors and lawyers that restate the law in particular areas. He added that one of those areas is the law of trust and that he is one of the advisors of the Restatement of Trusts Third which has been in process of preparation since 1988 and is still in preparation at the moment. Mr. Wyatt is a member of the American Bar Association. Mr. Wyatt stated that Mary Eads of Greenbaum Doll & McDonald, Louisville, Kentucky, will be serving with Mr. Wyatt as legal Counsel to the Commission.

Mike Burnside, Deputy Secretary, Finance and Administration Cabinet, informed the Commission that the Request for Proposal for an actuarial and benefits consultant to the Commission closed in May. Mr. Burnside stated responses from very qualified firms were received and the committee has met twice and will meet again within the next week. Mr. Burnside indicated it was the intention of the committee to make a selection by the end of June.

Secretary Farris indicated the next three items on the agenda were 30-minute presentations on the budget impact for school systems, cities and counties and the Commonwealth. The first presenter was Alicia Sells, Director of Governmental Relations, Kentucky School Boards Association (KSBA). Ms. Sells stated that Secretary Crall asked her to give a snapshot of how the current pensions system is affecting school district benefits. Ms. Sells stated that as a representative of KSBA, she spoke on behalf of the individuals who are elected to manage Kentucky 175 public school districts.

> Local school boards are charged with setting the district budget for local school districts in Kentucky and school boards are responsible for setting salary and pension. There are 50,861 certified employees in Kentucky school districts and 47,276 classified employees and school district classified employees comprise 56 percent of all Kentucky retirement systems members. School districts are the largest employer in 67 counties of the state, the second largest in 23 counties, and the third largest in 14. Compensation at the school district level is a three-legged stool comprised of salary, health insurance and retirement. If the funding is sufficient for all three legs of the stool, the stool is in balance. If the funding is insufficient for any one particular piece the stool becomes unstable. Funding for school district compensation is derived from state, federal or local funding but regardless of the category, the taxpayer is funding the compensation for school district employees. The state funds retirement for non-federal employees, health insurance for full-time non-federal employees and a portion of salary increases for school district employees. Federal funding relates to employees that are working in school districts based on funding from federal grants. If a school district receives federal funding for a program, the salary, any salary increases, retirement, and health insurance for the employee are paid through the federal programs. Local funding is derived from local districts' taxing capacity to pay social security for classified employees, Medicare of classified employees, rank and step salary increases and making up gaps where federal and state funds are insufficient. The County Employees Retirement System rate increases have jumped from 6.34 percent in 2002-2003 to 16.17 percent in 2007-2008. The rate increase for FY06-07 cost local school districts $45 million. Increased pension costs and mandatory salary increases with cuts in federal programs result in layoffs and program cuts, two things that cause local school districts concern. For FY07-08, the General Assembly mandated a 5 percent salary increase for classified and a $3,000 salary increase for certified employees and the state funded those increases at a cost of $259 million dollars. Local districts provided rank and step salary increases out of local district budgets. KSBA supports the increases, but the mandates become a challenge for them when you consider pension and health insurance benefits. The pressure in local school districts to find a way to fund the mandates often leads to program cuts and layoffs. Local school boards are debating the questions of sustainability of benefits; what the costs of sustaining would be; if sustained, would it be at the expense of children; and will the taxpayer support what it takes to sustain. Between 1996 and 2008, health insurance and retirement costs accounted for 50 percent of all new money allocated for education. Between 1990 and 2005, health insurance and retirement costs jumped from 15 percent to 25 percent of the state education budget. KSBA

will continue to argue that more revenue is the answer, but the challenge is where does the revenue come from and will the taxpayer will continue to support more revenue. Many classified employees are paying to work because their salaries are low and health care is so expensive that at the end of the month, they must pay additional money for heath care. A critical issue for local boards continues to be how to answer the taxpayers who raise the issue of why their tax dollars are spent to fund insurance plans for public employees when they can't afford health care themselves. Some of the challenges that face local districts are the recruitment and retention of employees and how to integrate changes for new employees into the existing workforce.

The following questions were raised:

1. Brian Crall asked Ms. Sells to elaborate on the tension of how can we sustain and how can we not sustain. Ms. Sells stated that one of the concerns for school district is competition from surrounding states and whether or not a teacher may be able to make more money in Indiana or Ohio. One of the things that KSBA will be looking at is whether or not the pension systems and health insurance benefits are better in surrounding states than they are in Kentucky and would that be a tool that could be used when recruiting teachers to the Kentucky even though salaries are lower. Mr. Crall asked which tension appears to be greater. Ms. Sells stated that salary would move over the other considerations in large part because you are recruiting younger people.

2. Senator Borders asked if there are a minimum number of hours that classified employees must work to qualify for health benefits and is the system paying the same portion for all employees. Ms. Sells stated the standard is 30 hours to receive a health benefit funded by the state. Ms. Sells that some employees may be paying to receive the single health insurance coverage because they are not working 30 hours.

3. Bill Hanes pointed out that the issue in cost to KSBA is that there are more health insurance costs in the pension note since implementation of GASB. He stated that when discussing pensions and increasing pension costs, a different government accounting standard applicable to health insurance is being implemented. He stated he wanted to emphasize that the issue is actually related to health insurance and not pensions.

4. Representative Moberly stated that Ms. Sells commented there was no problem with the certified employees in KTRS but there is a problem with health insurance for certified employees through KTRS. The state has borrowed $290 million to ensure health benefits for certified employees of KTRS were not decreased. Representative Moberly stated that the state would not be able to borrow from the system again so

the full amount would have to be paid which would be well over $100 million to keep benefits for retired certified employees.

6. Brad Cowgill asked if KSBA has conducted a market-driven study for the purpose of determining whether our current retirement package makes employment as a teacher in the public school system in Kentucky more or less appealing by comparison with other states. Ms. Sells indicated that KSBA has not conducted a study of that nature. Ms. Sells stated that that would be a question to ask the certified employees.

Gary Harbin stated that the average starting age of teachers in Kentucky is 31 and the average starting age of teachers who retired in Kentucky this year was 27. He pointed out that the inference was that people are becoming teachers later in life and that may be due in part to the benefits offered.

Sylvia Lovely, Executive Director, Kentucky League of Cities; Neil Hackwoth, Deputy Executive Director, Kentucky League of Cities and former Mayor of Shelbyville; and Bob Arnold, representing the Kentucky Association of Counties, presented an overview of the County Employees Retirement System (CERS).

Ms. Lovely began by talking about The Coalition for Sustainable Benefits which is a joint effort between the Pritchard Committee for Academic Excellence, the Kentucky League of Cities and the Kentucky Chamber of Commerce which came together out of shared concern for escalating costs of public employee benefits. The Coalition advocates balance, flexibility, affordability of benefits for public employees. The core message of the Coalition is that increasing benefit costs are threatening basic services and are unsustainable. The Pritchard Committee has found that in the Education arena that retirement costs, and in particular heath insurance costs, are spiraling out of control are eating up an increased shared of education funding. The Chamber consists of business leaders vitally interested in developing competitive communities for economic development including a fair system that balances caring for its workers and also for the taxpayers who truly fit the bill.

> The County Employees Retirement System (CERS) involved the local taxpayer who foots the bill for the spiraling costs of heath care and it is an unsustainable system. There is a future problem, but there is also a current problem because for the next twenty years the bulk of the baby boomers will be retiring. Health care costs are among the most difficult issues to solve. The spiraling costs have resulted in lost raises, layoffs, attrition and privatization of services for communities. Cities and others in CERS are experiencing a huge cash flow crisis. All agencies in CERS will be paying close to $1 billion in the next fiscal year for retirement benefits and in the next 5 years the same employers will pay almost $2 billion for retirement costs. These costs will merely maintain services not expand them and other public services will suffer. Employers such as city and county

governments pay a contribution rate as a percentage of salary for active employees. These rates are projected to more than double by fiscal year 2013. The trend will have a significant impact on all employers in CERS especially cities and counties which have large public safety employees groups. Pension costs are straining city budgets and layoffs and staff cuts have resulted throughout Kentucky. Cities like Louisville Metro cannot afford additional services for residents and businesses because CERS payments use up most of the city's annual growth. Key points to remember are city retirement costs increased 50 percent in the last two years and will double in five years. Cities have already cut staff, raised taxes or expended reserve funds. The goal of the League of Cities is to find ways to reduce costs for the state, local governments, and school districts while providing the best possible health coverage for working employees and retirees.

Bob Arnold stated that many counties have the same issues that cities do. Excluding Fayette and Jefferson Counties, in 2003 fiscal courts paid in $17.3 million into CERS. In 2006, counties paid in $38.6 million with only a 4 percent increase in payroll. The 2013 projected contribution rate is an increase of 600 percent. An increase of this type would severely impact services to the community. Classified employees of school districts are an issue facing cities and counties. Fifty-eight percent of the employees in CERS are school district employees who work for nine months but receive the 12 month credit.

Neil Hackworth stated that in 1988 all local pension systems except Lexington Police and Fire were closed and had to participate in CERS if they wanted a defined benefit plan. CERS membership is comprised of school boards (51 percent), cities (9 percent), counties (25 percent), police and fire (5 percent) special districts (6 percent), sheriffs (1 percent) and other quasi governmental groups (3 percent). Cities and counties have no ability to reduce their retirement costs. The KRS Board of Trustees sets the amount that has to be paid in and CERS is expected to make the payments. There is some concern about the composition of the Board of Trustees. There are two CERS representatives, but there is no requirement that employers or management at any level be represented on the Board. Cities and special taxing districts are limited to what they can raise to meet the rising cost of health care. For example, fire districts are limited to 10 cents per hundred on property valuations and House Bill 44 limits the amount of additional revenue that can be collected. School boards also have limitations as it relates to property taxes. The required employer contributions are skyrocketing and revenues are not keeping pace with the expenditures. The crisis for the cities and counties is a health care crisis and not a pension crisis. Employers are required to pay the rate set by the KRS Board of Trustees and have no opt out provision with the law. Cities with large numbers of policemen and firemen are hit particularly hard and need relief in the short-term. The salary package for city and county employees includes salary, health benefits and retirement. There are employees who do not participate in the state health plan as actives but later participate as retirees. Employers fund the health insurance benefit for the retirees. The health benefit is more costly for hazardous duty employees because they receive full family coverage after 20 years of service; however, this benefit was modified by legislation and future employees do not receive this same benefit. It is believed that Kentucky is unique because it is the only state in the nation whose cities with a defined benefit plan are mandated to participate in the state's health insurance plan upon retirement. GASB 43 and GASB 45 are financial reporting requirements but the KRS Board of Trustees treats those requirements as funding requirements. Bond rating agencies do not require the same aggressive funding strategy. These agencies have indicated they would like to see substantial progress toward the solution of the problem, but not necessarily full funding at any particular time frame.

Bob Arnold reiterated that cities can only raise funds through limited means. Counties can raise funds through property taxes, and occupation tax, and insurance premium tax. Counties over 30,000 can only raise funds through occupation tax (one percent).

The following questions were raised:

1. Regarding the slide Projected CERS Contributions, Frank Hatfield noted the employee contribution was flat but asked if the employee rate would increase with salary increases or increased personnel. Mr. Hackworth stated the chart is based on current salaries and not future salaries and shows the relative contribution rate.

2. Regarding the slide Insurance Costs: CERS Retirees, John Hall asked if the chart reflected what retirees paid per member per month. Mr. Hackworth stated the chart reflects the cost that is paid per retiree. The retiree does not pay anything. Mr. Hall asked what the benefits under the plan were. Mr. Hackworth deferred to Secretary Birdwhistell to answer. Secretary Birdwhistell stated that it includes minimal co-insurance on some CERS plans. Secretary Crall stated that the chart reflects costs for the pre-65 retirees and they receive the same health insurance benefits that active state employees receive. Mr. Hall asked if the employees reflected in the charts were eligible for Medicare. Mr. Hackworth stated that when the reach Medicare age, they begin receiving the supplement but the chart does not reflect those costs. Mr. Hall asked if the numbers would be lower once the retiree reaches Medicare age. Mr. Hackworth stated that was correct.

3. Regarding the slide Insurance Costs: CERS Retirees, Brent McKim stated that it was his understanding that there was a premium equivalent for each covered

individual who had the enhanced plan and if someone participated in the state health insurance group that would have been a flat amount that cities, counties, school boards, etc. would have been charged per employee. Mr. Hackworth stated that all costs are lumped together and one rate is paid. Secretary Crall stated that the chart reflects costs associated with the health plans for the retirees in CERS. Mr. McKim asked what the premium equivalent for the single enhanced plan for a covered city or county government would be. Secretary Crall stated that is was the same premium as an active employee.

4. Regarding the slide Who's In and Who's Out, Brent McKim asked with regard to the yellow bar, if the state would pay $175 per month for each of the individuals who opted for the flexible benefit plan. Mr. Hackworth stated that the flex plan is a HRA plan. Mr. McKim asked if someone moved from the flexible benefit plan to a covered plan, would the amount being paid would increase. Mr. Hackworth stated that was correct and any additional cost incurred by moving from one plan to the other would be paid by cities or local governments. Mr. McKim asked would the cost to the state would be if the blue bar was eliminated. Mr. Hackworth stated local governments would be forced to pay the additional costs. Secretary Farris stated that this chart was a snapshot in time and that the benefits consultants will look at trends and time series of data.

5. Regarding the slide Projected CERS Contributions, Representative Moberly asked what the anticipated employer contribution rate would be after 2013. Mr. Hackworth stated that presumably it would be the same. Representative Moberly asked what would be the effect on cities and counties if the rate continues at that level. Mr. Hackworth stated that the impact would be increased taxes, layoffs, and services being cut.

John Hicks, Deputy Director, Office of the State Budget Director, discussed Budgeting for Retirement Systems Costs.

There are significant differences in budgeting for the Kentucky Employees Retirement System and the Kentucky Teacher's Retirement Systems. Some of the differences are: (1) the contribution rate is set by statute for KTRS but not KERS; (2) there is a direct appropriation to supplement the employer contribution rate for KTRS but not KERS; (3) medical insurance is pre-funded and a part of the inviolable contract for KERS but not KTRS; (4) there is a cost of living adjustment for retiree benefits included in the employer contribution rate calculation in both systems but only for prior years for KERS and with some supplement for KTRS; and (5) sick leave credit is included in the employer contribution rate (serviced increased by the value of sick leave accumulated at the time of retirement) for KERS but not in the employment contribution rate for

KTRS. The budget process for the employer contribution rate begins with an actuarial recommendation provided by the Board of Trustees of KERS for the full contribution rate. The Legislative Research Commission then promulgates the two year biennial budget instructions that all state agencies and universities must follow when submitting their agency budget requests. The Governor makes a recommendation on the Executive Budget and the General Assembly then deliberates and enacts a budget. The Commonwealth has a biennial budget process but has annual budgets. Cities and counties have annual budget processes and annual budgets. For KERS Non-hazardous, Hazardous and State Police contribution rates, the estimates are provided by the system through the actuarial analysis. LRC publishes the information in the budget instruction. For KTRS, the employer contribution rate is set by statute and is accommodated in the biennial budget request of the Department of Education. Separately, KTRS submits a budget request for funding for other costs of KTRS that are not accommodated by the employer contribution rate. The Governor is required to submit a balanced budget to the General Assembly and he considers the recommendations from the actuarial analysis of KERS and the recommendation of the KTRS agency and weighs those costs against all other budgetary needs before making a recommendation to the General Assembly. In those recommendations, the amount provided for the employer contribution rates are explicitly set forth as a part of the Governor's recommendation. For most Executive Branch agencies excluding universities, the Judicial Branch and the Legislative Branch, the retirement employer contribution rate is part of the building process of the budget, a cost factor that is calculated when building the budget. In other parts of the budget, retirement costs are part of the budget but are not specifically set forth as a single element. For example, for universities that participate in the KERS, the practice in the Commonwealth has been to lump sum those university budgets rather than build them from a cost element basis up which makes it difficult to place a definitive value on each universities KERS employer contribution. The public health departments and the 14 mental health and mental retardations boards are significant elements of KERS and although they are not state agencies, they receive a significant amount of funding through state agencies. The General Assembly weighs the cost of all the Governor's recommendations against all budgetary needs when trying to balance the budget. In 1993, KERS (Non-Hazardous) recommended a 8.66 percent employer contribution rate but the General Assembly only enacted a 7.65 percent rate. This was the first time that the General Assembly enacted a rated less than what was recommended. There was no difference between the recommended rate and the enacted rate until 2003 when the recommendation was 5.89 percent and the enacted rate was 3.76 percent. This was a result of the demutualization of Anthem insurance. Since 2003, the enacted rate has been much less than the recommended rate. In 1993, the KERS Board challenged the General Assembly's action in the budget bill and in 1995, the Supreme Court ruled in favor of the action in the budget saying that the KERS Board has no power to mandate rates of contribution and require their adoption. KERS has computed the value they have estimated of the total assets that are under funded by the General Assembly not enacting the recommended employer contribution rates. Prior to July 2006 valuation, the total compounded value for pension and insurance funds (mostly non-hazardous) with compounded interest earnings lost was $759 million. After the 2006 valuation with the significance difference of the GASB reporting on insurance, the same under funding increased to $1.3 billion. For fiscal year 2007, there is a total of $158.5 million explicitly in the budget for employer contributions for KERS with approximately 60 percent of those costs are born by the state's General Fund. The estimate for total employer contributions for fiscal year 2008 has increased to $178.1 million and is reflective of the rate changes proposed for non-hazardous employees from 7.75 percent this year to 8.50. The statutory contribution rate for KTRS is 13.105 percent. The enacted budget has typically funded the statutory rate. The rate is made up of several components; 9.105 percent for the retirement fund, 0.75 percent Medicare insurance and a 3.25 percent overmatch. The overmatch was instituted to accommodate a liability to amortize a known liability at that time. The General Assembly gave the KTRS Board the capability to use part of the 3.25 percent overmatch to fund medical insurance costs. The system costs for KTRS in the budgeting process included the employer contribution rate and direct appropriations to KTRS. For fiscal year 2006-07, budget costs for KTRS included $323 million generated from the employer contribution rate for school districts and participating agencies, $157 million in direct appropriations to KTRS from the General Fund and $12 million from the General Fund Surplus Expenditure plan. The total amounted budgeted for fiscal year 2007-08 is $535 million. Costs in the KTRS budget that are funded through direct appropriations and not the employer contribution rate are the amortized cost of living increases (COLA) above the 1.5 percent statutory increase, amortized cost of sick leave benefit, medical insurance and other smaller costs including minimum benefit adjustments for older retirees. In fiscal year 2007-08 the costs remain fairly consistent except that the General Assembly in the 2008 budget provided an additional $20 million to KTRS and gave the Board the discretion to decide how much of that $20 million to allocate to pension or medical benefits. The medical insurance program for KTRS is on a pay-as-you-go basis and in the past two budgets the amount appropriated to the cover the cost was less than the pay-as-you go amounts. To cover those costs the medical insurance fund borrowed from the pension fund amortized over a ten year period at 7.5 percent. The additional cost of living increase (above the statutory 1.5 percent) is set in the budget bill and the amount budgeted is based on a 20-year amortization of the additional cost. The benefit of adding sick leave for service credit was provided in 1992 and the budgeted cost to the system of sick leave credit is based on a 20-year amortization scheduled. For fiscal year 2006-07 the explicit combined total amount included in the budget for KERS and KTRS is $650 million and for fiscal year 2007-08 the total is $713 million. Roughly 88 percent of the funding will come from the General Fund tax base. The rating agencies are consistently updated on the financial condition of the Commonwealth, including the unfunded liability level of the pension systems for full disclosure. Although GASB rules have changed the way the liability is calculated, Kentucky has always disclosed its estimated medical liability.

The following questions regarding the presentation were raised:

1. Chairman Moberly commented that no General Assembly has enacted less that a Governor's recommendation and in some cases has enacted more. He emphasized that even though the General Assembly had not been matching the requested contribution rate, they have made increases in funding retirement systems.

2. Frank Hatfield stated that it should be noted that what is included in the budget for matching social security for those employees other than teachers because it makes a significant difference in what the state is contributing toward retirees. Mr. Hicks stated that information could be provided to the Commission.

3. Regarding the slide Teachers' Retirement Systems Costs in the Budget - Medical Insurance, Jim Parsons asked how the 7.5 percent was calculated. Mr. Hicks stated that the 7.5 percent was the five year smoothing actuarially projected rate.

4. Representative Moberly stated that one of the considerations of floating bonds (pension obligation bonds) to pay off the debt is that the Commonwealth is paying 7.5 percent to the system and the bonds (pension obligation bonds) could be floated at an appreciable lower rate. He stated that will be a consideration in the next session because of the difference in the rates.

5. Shawn Ridley asked how much of the appropriation from the state budget for fiscal years 2006-07 and 2007-08 is from employees and how much from the investment funds. Mr. Hicks stated that information could be obtained for the members.

Ed Davis, Kentucky State Fraternal Order of Police, asked to address the Commission. Mr. Davis, a retired Jefferson County Police officer, stated benefits for police, firefighters and other city and county employees must be maintained. He stated that these individuals are important to communities and asked the Commission to not cut benefits to these individuals.

Secretary Crall asked if Mr. Davis' comment "...can we afford not to sustain" was related to current employees and retirees or future employees. Mr. Davis stated that agencies depend on pension benefits when retaining and recruiting employees, but he wants to protect current employees and retirees.

Secretary Farris assured Mr. David that the Commission understood the charge by the Governor and benefits to current employees and retirees would not be affected.

Ms. Lovely restated on behalf of local governments that the cities and counties are sensitive to their employees but they have a current problem as well as a future problem.

Representative Moberly stated that he understood the need to reassure employees but hoped that the Chairman was not making the statement that no co-pays or deductibles would increase.

Secretary Farris stated that the Commission is considering ways to fulfill the obligation to its current employees and retirees. Over the last few years, the health system has changed to ensure a fair and balanced system for all employees. Modifications to health benefits will continue to be made as necessary every year. With regard to the pension plans and the obligation to current employees and retirees, it is the intent of the Commission to honor the inviolable contract.

Mr. Cowgill stated that the answer is provided by the charge that the members received from the Governor of trying to find a way to fulfill the obligations to current employees and retirees.

Chairman Moberly further stated the Commission needs all the information it can gather in carrying out the charge and no inference should be drawn because a consultant was hired to advise the Commission on the inviolable contract.

Secretary Farris informed the members that the next meeting will be held on July 23, 2007 at 1:00 p.m.

With no further business before the Commission, a motion was made to adjourn.